1812

THE NATIONAL CITY BANK OF NEW YORK EST. 1812

1944

Economic Conditions
Governmental Finance
United States Securities

New York, February, 1944

General Business Conditions

THE outstanding fact in the industrial situation is not only that war production has become so vast, but that the peak demand for war products is being met more comfortably than most observers had believed possible. The margin of raw material supplies above war requirements, particularly metals, has increased. Transportation needs are being met without development of bottlenecks, although with a thin margin of safety. The labor situation is tight, but not as tight as official estimates had forecast. The number of areas where labor shortages are acute or where critical shortages are expected, as designated by the War Manpower Commission, has declined lately, and the number in which there is a labor surplus has increased.

Possibly the labor situation may be tighter a little later, because workers who moved into the industries from the farms will need to go back when the planting season approaches. At the same time the draft of men into the armed forces will go on, Selective Service officials having stated within the month that a net increase of 700,000 must be provided by July 1, exclusive of replacements. On the other hand, there will be a normal growth in the labor force during the intervening months, and cutbacks in munitions schedules release workers for other jobs.

Also, increases in the output of labor reduce the need for more labor. There are an encouraging number of reports of war manufacturers who have been able to reach and carry on capacity output with fewer workers than they expected to need. This does not signify that labor efficiency is ideal, but the gains reported help to balance the unfavorable aspects of the situation, such as excessive turnover, absenteeism, limitations on individual output through "feather bedding" and other restrictions, and finally the strikes which Secretary Stimson says caused in one week the loss of 135,000 man-days in the output of vital war material.

In many cases the reduction in man-hours per unit of product, as experience with unfamiliar products has been acquired and the benefits of new machinery and of mass production realized, has been sensational. It is equivalent to an addition to the labor force; it is of incalculable value not only because it increases production and eases the strain on the industrial organization but because it reduces costs; and it shows what could be accomplished where output is lagging, by better methods or by a stronger will to work.

Fourth War Loan

As this Letter goes to press, the country is in the midst of the Fourth War Loan, to raise $14,000,000,000. A larger army of volunteers is at work; the results thus far are encouraging. With our armed forces moving forward in the Pacific and in the Mediterranean, and poised for the major battle for Europe, the American people are responding to the challenge of Back the Attack. This response will assure the success of the Loan.

Announcement has been made that an additional $14 billions of War Department appropriations for 1944 (over and above $13 billions announced in November) will not be expended, but will revert to a budget reserve; and of this new "saving" nearly $12½ billions is represented by reductions in equipment prices. It should be said again that such reversions of appropriations do not signify that estimates of war expenditures can forthwith be reduced by an equivalent amount, since appropriations are only authorizations and bear no close relation to schedules of current disbursements. But the price cuts reduce the ultimate cost of the war, and the gains in productive efficiency which they represent make the war effort more effective.

W.P.B. Policy on Reconversion

The fact that a margin of productive capacity over war requirements is appearing is

recognized by the War Production Board, whose chairman, Mr. Nelson, said in a speech in Chicago during the month that the country is "coming into a period in which there may well be a certain amount of idle manufacturing facilities, idle materials and scattered pockets of temporarily unemployed men and women." Mr. Nelson added, however, that no substantial reconversion of plant facilities to civilian goods output is to be countenanced for the present. and the Board has made three decisions conforming to that policy. It has decided not to revoke or make any blanket modification of the regulation prohibiting the use of steel in a long list of civilian products. Second, it has decided not to lift present restrictions on new building construction. Third, although the copper situation is easier, a spokesman has announced that no general release of copper for civilian use will be made.

Mr. Nelson has said that he "would rather be two months late in reconversion than five minutes late in military production." To draw the line exactly between cases where reconversion would use only idle labor and materials, and where it would interfere with a needed shift of workers into war plants that are still expanding, is difficult; and it would be indefensibly reckless to make any but conservative decisions. Moreover, it is inadmissible to take anything for granted in the military outlook. If, for example, the expected assault on western Europe should be repulsed, facilities now closing down might be needed for war production again. The country can better afford to keep plants in a standby condition for a time than it can afford to find them unavailable, if need develops, because they have been permitted to reconvert, with different machinery, to civilian production.

Reconversion policy may be considered subject to change if the military situation develops favorably and further cutbacks in war production become possible, and the W.P.B. position does not foreclose greater allotments of material for civilian use now, where circumstances clearly permit. A considerable number of orders relaxing previous restrictions have been issued during the month, although as related to the whole economy they are of minor importance. In addition, a test of the feasibility of permitting small concerns to make more civilian goods is to be carried out in three regions, which can be extended if it develops that war needs are not interfered with.

Who Shall Reconvert First?

Mr. Nelson's views probably are also influenced by the difficulty of permitting one consumer goods manufacturer to reconvert before his competitors can be released from war work, for an obvious inequity is involved. This is one of the most troublesome of the reconversion problems, — assuming that reconversion must be spread over a considerable period and therefore piecemeal in character, which seems likely. In the case of the program for the manufacture of 2 million electric irons, the decision was to allot quotas to each manufacturer. Those who are unable to make their own irons because they are on war work are expected to have them made by others as designated by W.P.B. There is considerable doubt that this system will work well in the iron program, and it would be inapplicable to a good many articles, including automobiles. What of new people who want to get into the business?

As time goes on, the fact that there may be a conflict between restoring civilian production rapidly on the one hand, and giving competitors fair and equitable treatment, on the other, will have to be faced squarely. The public interest, unquestionably, is to maintain production and employment and therefore to substitute output of civilian goods for military production, as the need for military goods falls off, as rapidly and smoothly as possible. This is not solely a matter of making consumers more comfortable but of absorbing surplus raw materials, putting goods in the market to satisfy accumulating needs, and reducing the inflationary menace. The great danger in the post-war period is of a scramble for manufactured goods, and the sooner production can be resumed the less the scramble will be. As far as is compatible with these principles, it is of course desirable to preserve competitive positions equitably.

It is something to ponder that questions such as the extent and order of industrial reconversion can require serious consideration in a country which is carrying on the tremendous enterprise of a world war, and long before the end of that war can be foreseen with any assurance. There never has been as striking evidence of the resources available to the United States, of the stupendous accomplishments possible under its mass production techniques, or of the competence of its industrial management and the productivity of its labor.

Possibly others of the United Nations, noting the discussions going on here, may wonder whether our war effort is not being unduly relaxed. They should understand that these moves are taken only because American factories have already built reserves of some war materials, which permit production to be cut back without danger of shortage. The diversion of resources from these to other war products is bringing closer the day when the armies of the United Nations will have enough of everything, a condition unprecedented in the history of war; and enough has been said to show that diversion to the manufacture of air-

planes, landing craft and other war goods still badly needed takes precedence over reconversion to civilian use. To a modest extent, cutbacks of production of war materials are also under way in Great Britain and Canada.

Provisions For Contract Termination

The first report from the group headed by Bernard M. Baruch, which is advising Mr. Byrnes, the War Mobilization Director, upon contract termination and other problems of the demobilization period, has come from the Joint Contract Termination Board, of which John M. Hancock is chairman. The function of this Board is to establish principles and policies and make recommendations which will lead to prompt and just settlement of cancelled war contracts. Cancellations of course are occurring all the time and settlements are being made, but it is recognized that present procedures are not adequate for the pressure that will develop when the tide reaches flood at the end of the European war.

The Joint Board has submitted two documents: a draft of a uniform termination article to be embodied in all future contracts and to replace, by agreement, the articles in existing contracts; and a statement of principles to govern determination of costs in making settlements. Mr. Byrnes ordered both put into effect at once.

All students of the problem have emphasized the importance of establishing a uniform article so that termination by the various contracting agencies will be governed by a common set of provisions, which eases the problems of contractors and facilitates settlements by one agency on behalf of all. The new article establishes the rights and obligations of the agency and the contractor, and is fair to both. It provides for a negotiated agreement upon the amount due the contractor and establishes a formula to be followed if there is failure to agree.

The clause does not provide for advance payments of any fixed percentage of claims at any stated time, but says: "The Government shall make partial payments and payments on account . . . whenever in the opinion of the contracting officer the aggregate of such payments shall be within the amount to which the contractor will be entitled." Probably some contractors will consider this a weakness, on the ground that it is indefinite and leaves too much discretion to the contracting officer. However, it can be argued soundly that no schedules can be correct or practicable in all cases, that the writing of inflexible provisions into the clause would interfere with the most effective administration of contract settlements, and that prompt payment will actually be facilitated by giving the contracting officers, operating under a general directive, a good deal of leeway.

An Administrative Problem

Business men understand, but the general reader may not, that the uniform clause itself is only the beginning of the solution of termination difficulties. The new statement of principles for the determination of the costs for which the contractor will be reimbursed is a further step, and its fairness and comprehensiveness go far toward assuring that contract settlements will be just. To make settlements prompt as well as just, however, is an administrative problem. The all-important questions are how the organization to administer termination is set up and operated, and what procedures are established for presenting and passing upon claims and getting the money out rapidly both to the prime contractor and to subcontractors. Much will depend upon the personnel employed, their training, and the extent to which they are imbued with the principles laid down and impressed by the vital importance of doing their work promptly and effectively. An important requirement, for which legislation is necessary, is that contracting officers should be relieved of personal financial liability, except in case of fraud.

Contractors also will have to contribute a great deal toward facilitating settlements. They will need to familiarize themselves with procedures and to have their accounts in shape for the prompt submission of their claims in the form required. It is becoming common practice among contractors to designate an officer and staff in charge of termination, to handle these matters. The Termination Board will make statements later on other problems: (1) settlement procedures, (2) keeping of adequate records, (3) appeals, (4) company-wide settlements, (5) disposal of property, (6) payments and loans, (7) problems of subcontractors, (8) legislation. Not until these statements are ready will contractors have the whole picture of what they must do and what they may expect.

Appreciation of the tremendous importance of the termination problem has become general in recent months. Primarily concerned are the companies which have converted wholly or chiefly to the manufacture of war products, and which face a reconversion of equal magnitude when their war production ends. At that time they will be left with raw and partly fabricated materials on hand and committed for, heavy tax obligations, large accounts payable, accrued payrolls, and possibly debts. Their cash will be tied up in inventories or absorbed by payment of taxes and other accounts just when they need money for reconversion and purchase of new materials. Unless they obtain cash promptly for their inventories of war goods, and have the goods removed promptly from their plants, reconversion will be handicapped; unemployment will result, and the ef-

fects will be felt around the circle, including not only the war producers but their subcontractors, their suppliers, and the merchants who look for a market among their workers.

The Raw Materials Situation

The easing in raw material supplies is pronounced in the metals and in wool. At the opposite extreme, hides, leather, rayon and lumber continue as tight as ever and paper is tighter, as are some chemical materials needed in synthetic products. Synthetic rubber output is not as large at this time as had been hoped, but is expected to improve rapidly in the near future.

In recent weeks the War Production Board has partially lifted the blackout on metals statistics, and the figures show that production in most cases is running in excess of war needs plus the restricted civilian allotments. Zinc producers' stocks have increased in every month since May 1942 when publication of the statistics was suspended, and at the year-end stood at 173,755 tons compared with 18,447 on May 31, 1942. This is by far the highest level ever reported. It is exclusive of consumers' stocks, which the American Zinc Institute says are quite substantial, and the Government has in addition a small stock of foreign zinc imported in refined form.

Producers' stocks of copper at the year-end were still close to the record low, but the stockpile now held by the Metals Reserve Co. is estimated at 250,000 tons or more. In copper consumption, the reduction due to the cutback in the small arms ammunition program appears to be fully offset by increased schedules for artillery shells and naval requirements, and by return to the use of brass shell casings where steel has been employed. If imports are continued at recent rates, however, overall copper stocks can be expected to rise moderately. Producers' stocks of lead also are not heavy, but the overall position including the government stock of imported lead is entirely comfortable.

Tin is almost the only metal of which there was a large stockpile on hand at the time of Pearl Harbor; and by means of drastic restrictions on consumption, imports of refined tin from the Belgian Congo and imports of concentrates from Bolivia (refined at Texas City), the drain on stocks has been held to moderate proportions. Assuming continuation of imports at the recent rate, the gap between consumption and new supply can be filled out of stocks for several years.

Aluminum production has exceeded consumption for about a year, and during the last quarter the excess at one time rose to above 40 million pounds a month. This led to two decisions, one to use up to 100 million pounds of aluminum in the mats employed in making landings on beaches, and the other to cut back production. Fifteen production lines have now been shut down, with about two more to follow, according to W.P.B. The cutbacks will leave ample current production and ample reserve stocks. In magnesium also, there is much evidence that stocks are increasing as production rises.

In the ferro-alloys stockpiles have reached large proportions, both through imports and the stimulation of domestic production; and W.P.B. has allowed producers of alloy steels to return to regular peacetime formulas in the use of tungsten, molybdenum, vanadium, chromium and nickel. Stocks of manganese, of which steel companies usually keep an ample supply, have been built up further during the war. In all the metals the government agencies have ceased to make new contracts to pay premium prices for production from high-cost domestic mines, and a few small contracts to buy foreign metals which have expired were not renewed.

The most extreme easing in any raw material market has been in mercury, in which W.P.B. says stocks sufficient for two years at the current rate of consumption have been accumulated. In this case existing contracts with domestic producers were cancelled effective February 1, and the market price has dropped from $197 per flask to $130. This is the only primary metal price which has declined, so far as has come to our attention, but prices of nearly all non-ferrous scrap metals have dropped, in some cases very sharply.

Post-War Implications

This surplus of metals, developing at a time when consumption is far above anything ever known, is entitled to very close attention in making appraisals of the post-war situation. It is not likely to disappear during the war, for while essential civilian needs can and should be met to the extent that the labor supply and available plant facilities permit, there can be no full restoration of civilian consumption of metals until the plants and labor engaged in war can be released. At that time the war stockpiles will still be in existence, scrap supplies will be enormous, and the world will have a vastly greater capacity for production of many metals than before the war. In the United States and Canada alone the expansion in aluminum capacity has been something like 1½ million tons, while the tonnage of magnesium produced, measured before the war in the ten thousands, is now measured in the hundred thousands. Copper capacity has been increased relatively little, but world production now is probably 40 per cent, or almost a million tons, greater than before the war.

Much of the war-stimulated production increase in mining, especially in this country, has

been of the high cost variety, and probably many of the new ventures will not long survive the war. No elaboration of the facts is needed, however, to show that production is likely to be abundant for all requirements and that competition for markets will be keen. The metal industries recognize this, and are supporting proposals that the Government hold on to its stockpiles after the war, reserving them solely for military use in some possible future emergency or for the time when the declining ore reserves in the United States finally approach exhaustion.

There is continuous interest, conjecture and exchange of opinion among business men and economists as to the course of prices after the war. Many are convinced that a sharp rise is inevitable. They point to the replacement of the property destroyed, to the satisfaction of wants deferred, and to the tremendous accumulation of liquid assets in the form of increased bank deposits, currency hoarded, and redeemable securities, which people will have available to pay for the goods they want. They point further to the high level of wages, and to the strength of the labor and political forces which will tend to maintain wage rates after the war. Many non-ferrous metal producers would be unable to operate at present labor costs without the premium prices which the Government pays them for over-quota production.

The principal counter-influence on these inflationary elements will be the capacity of the industries to supply market requirements — a capacity which in numerous lines has been increased during the war. Supporting that capacity, an abundant supply of raw materials may provide an anchor to the price structure; or to use another figure of speech, a weight to keep the balloon down.

There is a fundamental lack of harmony between the fears of the metal producers that their markets will be depressed, their mines closed and their workers unemployed, on the one hand, and on the other the fears of those who think an inflationary price debauch after the war is inescapable. Nor are the metal producers alone in considering that they face grave problems. The National Wool Growers Association held its annual convention in Denver during the past month, and the chief subject discussed was the wool surplus. On the same day, as it happens, a meeting of a committee of the National Cotton Council was being held in Memphis. It was addressed by Mr. Ransome Aldrich, President of the Mississippi Farm Bureau Federation and a cotton planter, who declared that the cotton industry must reduce its costs all the way from the field to the spinner to prevent serious inroads by synthetic fibers and other competing products. The world output of rayon and staple fiber was recently estimated to have reached almost 3½ billion pounds in 1942, compared with about 2 billion before the outbreak of the war.

The conclusion to be drawn is that in a broad list of industrial raw materials there are not likely to be sellers' markets after the war. In some the contrary is indicated, and the demand on the Government will not be to keep prices down but to hold them up. This is but one of the factors that will influence the post-war price level, but for the long run at least, and possibly for the short, it is surely not the least important.

The Federal Budget, 1944 and 1945

The annual budget message, projecting for the fiscal year 1945 a second consecutive $100 billions budget, confirms the President's characterization of the budget a year ago as "presenting the maximum program for waging war." In estimating total war expenditures, excluding agencies financed outside the regular budget, at $88.2 billions—about the same as revised estimates for fiscal 1944 and $9 billions under original estimates for 1944 presented a year ago—the President recognizes that the war program has indeed reached its peak of maximum output.

During the earlier stages of the armament program the budget estimates, as the President says, were based on maximum output in the light of available facilities, raw materials, and manpower. Even though actual industrial production repeatedly exceeded expectations, the maximum was never enough to fill the requirements established by our military leaders.

Now, however, the situation has changed. The construction phase of the program is virtually completed. With materials and supplies pouring from converted and new plants in an ever-increasing torrent, the point has been reached where supplies of some types of munitions have piled up in excess even of the demands of total war, making possible substantial cutbacks in production schedules here and there at the same time that output in other lines is still being pushed ahead. Thus the program is no longer one calling for overall increases in production, but rather for readjustments to fit the changing conditions of war.

The achievement of American industry in carrying forward this gigantic effort is mirrored in the President's statement that "we have converted and diverted approximately half of our resources to war purposes. In the production of munitions we now almost equal the rest of the world combined."

1945 Estimates Highly Tentative

Estimates for the fiscal year 1945 are of course of highly tentative character. In view

of the uncertainty as to when the war will end, the President has projected a program of general magnitude approximating the revised figures for the current fiscal year. Should the war in Europe end within this calendar year, as has been predicted by General Eisenhower and Admiral King, actual war expenditures undoubtedly would fall well below these estimates. Total war costs would not be expected to decline as rapidly as war production, however, because of payments due on termination of contracts, mustering-out pay, and other demobilization expenses. As recently enacted by Congress, service men and women will, with certain exceptions, receive upon honorable discharge from $100 to $300 depending upon length of service and whether in this country or overseas, at a total cost estimated at $3.1 billions.

Even if the war should continue through fiscal 1945 there is a question as to whether the probable expenditures have not been overstated, in view of the tremendous outpouring of supplies and accumulation of stocks in many lines, and of price reductions in many items. Reference has been made to War Department savings of over $14 billions in the form of unused appropriations for fiscal 1944, following savings of over $13 billions disclosed in November, principally through the reduction of equipment requirements and in prices. While these "savings" have been taken account of in the revised budget estimates, they suggest the possibility of still further decreases in actual costs. Even the revised estimate for 1944 is more than $2 billions above the annual rate at which expenditures have run in January and the seven months.

While budget estimates for war expenditures are being reduced, the total of "all other" expenditures is rising, being estimated at $9,754 millions for fiscal 1945 compared with $7,451 now estimated for fiscal 1944 and $7,124 millions estimated a year ago. Chief factors in this increase are the higher interest charge on the public debt, higher expenditures for veterans' pensions and benefits, and greatly increased tax refunds, including issuance of bonds to cover the post-war refunds of excess profits taxes.

These "all other" items bring total budget expenditures, as shown in the accompanying long-term summary, to approximately $96 billions in fiscal 1944 and $98 billions in fiscal 1945. Adding agency net expenditures financed outside of the budget carries total expenditures to $99 billions in fiscal 1944 and $100 billions in fiscal 1945.

Sources of Revenue

Net revenue receipts for fiscal 1944, now estimated at over $41 billions, represent an increase of $8 billions over the original estimate submitted a year ago. This reflects application of the higher tax rates of the 1942 Revenue Act to rising national income and business activity, transition to a pay-as-you-go basis for individual income taxes, and introduction of withholding at the source of victory taxes and later 20 per cent of income taxes on wages and salaries. The extraordinary nature of the rise in tax revenues in recent years may be seen by reference to the long-term summary.

For fiscal 1945, estimated revenues, like expenditures, are highly tentative, but are projected at a rate slightly below 1944.

United States Government Receipts and Expenditures 1914-1945
(In Millions of Dollars)

Year Ended June 30	Total Net Receipts	Net Expenditures: National Defense	Net Expenditures: All Other	Net Expenditures: Net Total	Net Surplus or Deficit
1914	$ 735	$ 263	$ 472	$ 735	$ ...
1915	698	268	493	761	—63
1916	783	286	448	734	+48
1917	1,124	1,452	526	1,978	— 853
1918	3,665	10,838	1,859	12,697	— 9,033
1919	5,152	14,444	4,071	18,515	—13,363
1920	6,995	2,718	3,685	6,403	+ 292
1921	5,625	1,767	3,349	5,116	+ 509
1922	4,109	888	2,485	3,373	+ 736
1923	4,007	675	2,620	3,295	+ 712
1924	4,012	603	2,446	3,049	+ 963
1925	3,780	626	2,437	3,063	+ 717
1926	3,963	599	2,499	3,098	+ 865
1927	4,129	614	2,360	2,974	+ 1,155
1928	4,042	648	2,460	3,103	+ 939
1929	4,033	698	2,601	3,299	+ 734
1930	4,178	721	2,719	3,440	+ 738
1931	3,190	667	3,004	3,671	— 481
1932	2,006	664	3,871	4,535	— 2,529
1933	2,080	651	3,213	3,864	— 1,784
1934	3,116	578	5,433	6,011	— 2,895
1935	3,800	726	6,284	7,010	— 3,210
1936	4,116	940	7,726	8,666	— 4,550
1937	5,029	967	7,210	8,177	— 3,148
1938	5,855	1,066	6,173	7,239	— 1,384
1939	5,165	1,251	7,456	8,707	— 3,542
1940	5,387	1,711	7,287	8,998	— 3,611
1941	7,607	6,301	6,409	12,710	— 5,103
1942	12,799	26,011	6,385	32,396	—19,597
1943	22,282	72,109	6,070	78,179	—55,897
1944‡	41,186	88,500	7,451	95,951	—54,765
1945†	40,769	88,200	9,754	97,954	—57,185

United States Government Public Debt, 1914-1945
(In Millions of Dollars)

June 30	Total	June 30	Total	June 30	Total
1914	$ 1,188	1925	20,516	1935	28,701
1915	1,191	1926	19,643	1936	33,778
1916	1,225	1927	18,510	1937	36,425
1917	2,976	1928	17,604	1938	37,165
1918	12,244	1929	16,931	1939	40,440
1919	25,482	1930	16,185	1940	42,968
1920	24,298	1931	16,801	1941	48,961
1921	23,976	1932	19,487	1942	72,422
1922	22,964	1933	22,539	1943	136,696
1923	22,350	1934	27,053	1944‡	197,600
1924	21,251			1945†	258,000

Source: Compiled from President's Budget Messages and Annual Reports of the Secretary of the Treasury. Expenditures exclude net appropriations to old-age insurance trust funds, while corresponding social security taxes are excluded from net receipts. Expenditures exclude sinking fund for debt retirement. National defense total excludes expenditures charged to War Department for rivers and harbors, and flood control; also for Panama Canal; but include loans to foreign governments in 1917 21 and lease-lend in 1941-45. †Budget estimate. ‡Revised budget estimate. Above figures do not include government agency net expenditures or guaranteed debt.

Net revenue receipts for the current fiscal year will cover over 41 per cent of total expenditures, based upon budget estimates and without allowance for the increased yield from the new revenue bill now in Congress. In addition, there will be collected $1.4 billion of social security taxes, treated as trust fund receipts and invested in special issues of government securities, thus helping to finance but not reduce the deficit. Therefore, should the pending tax bill produce an additional $2.3 billions of revenue, as indicated at this writing, total collections would be running at an annual rate of about $45 billions, or 45 per cent of total expenditures as now estimated.

Of the $41 billions of estimated net revenue receipts for fiscal 1944, $33.5 billions or 79 per cent is listed in the budget as coming from direct taxes on individuals and corporations, and this does not include $1.9 billion of social security payroll taxes paid by both employes and employers. Approximately $7 billions of tax receipts come from indirect taxes of all sorts —on tobacco, liquor, all other excise and manufacturers' taxes, customs and miscellaneous receipts. The way in which the burden of financing the war has been concentrated in direct taxes on individuals and business, principally income taxes, is indicated by the following table, comparing principal tax sources for the current fiscal year with 1939 before the outbreak of war.

Principal Sources of U. S. Government Revenue Receipts — Fiscal Years Ended June 30
(In Millions of Dollars)

Source	1939	Est. 1944	Change	% of Gross Receipts 1939	% of Gross Receipts 1944
Direct taxes on individuals	$1,422	$19,423	+18,001	25.1	45.6
Direct taxes on corporations	1,248	14,137	+12,889	22.0	33.2
Employment taxes	740	1,882	+ 1,142	13.1	4.4
Tobacco taxes	580	988	+ 408	10.2	2.3
Liquor taxes	588	1,509	+ 921	10.4	3.5
All other excise taxes	583	1,777	+ 1,194	10.3	4.2
Customs	319	420	+ 101	5.6	1.0
Misc. receipts	188	2,443	+ 2,255	3.3	5.7
Gross receipts	5,668	42,578	+36,910	100.0	100.0
Deduct					
Old-age insurance trust fund	503	1,392	+ 889		
Net receipts	$5,165	$41,186	+36,021		

It will be seen that while direct taxes on individuals and corporations have increased by fourteen- and eleven-fold, respectively, indirect taxes — excise taxes, customs and all other revenues combined — have increased but threefold, with their percentage of the total dropping from 40 per cent in 1939 to 17 per cent in 1944.

In view of comparisons often made between tax policies here and in other countries, it is interesting to find that this year we are collecting 76 per cent of our total revenue from personal and corporate income taxes, against 60 per cent in Great Britain and 65 per cent in Canada. In the United States, large additional sums are being collected from corporations through the renegotiation of government contracts.

Growth of Debt and Other Permanent Costs

With this year's excess of expenditures over receipts estimated at almost $55 billions, it means two years of federal deficits in excess of $50 billions; and if the war continues and the President's projections for 1945 are realized, it will mean — as the table shows — three years of such deficits. And this follows twelve consecutive years of smaller deficits to a grand total aggregate deficit for the fifteen years of around $220 billions.

Wartime spending, as the President says, "leaves its legacy of postwar debt" (as, it might be added, is true also of prewar deficit financing). By the end of this fiscal year the debt is estimated to reach $198 billions, and by a year hence, according to the tentative budget projections, $258 billions. Just where it would be if the program of those who claim that "we never spent enough" in the prewar years had been adopted may be left to conjecture.

All this involves piling up for many years a heavy burden of debt service charges. For the current fiscal year the interest payments, even at the low average rate of less than 2 per cent, are estimated at $2,650 millions, and a debt of $258 billions would require at the same interest rate payments of $5 billions annually, not counting anything for amortization. This compares with $941 millions in 1939, with $659 millions in 1930 when the public debt reached its post World War I low of $16 billions, and with $1,020 millions in 1920 following the wartime debt peak of $26.6 billions when interest rates were much higher than at present.

And this of course is not all. War inevitably leaves its aftermath of other permanently higher costs. Expenditures for hospitalization and benefit payments to disabled veterans constitute an obligation that the country is anxious to discharge fairly and generously. But invariably in the past political pressures have tended to swell the magnitude of veterans' bonus and pension payments. As for the huge sprawling government organization built up during the war, experience has shown how difficult it is to shrink this down once it has been created. For example, in the years following the past war, government expenditures declined only to a level around $3 billions annually, or just four times the prewar level.

That this country will want to maintain after this war a comparatively large and costly military and naval force is generally conceded. At the same time there are proposals for expansion of social security programs, and demands for

various kinds of expenditures from the Treasury for the benefit or relief of this or that group are certain to be heavy, especially if there should be a period of business recession and unemployment.

The foregoing presents a formidable picture of postwar government costs, and stresses the need for the most careful scrutiny of government expenditures to eliminate waste and extravagance. This scrutiny is imperative *now,* both for the purpose of keeping down financial cost and hence retarding the growth of debt that will have to be serviced after the war, and in order to release manpower from work that is non-essential to work that is essential in the war effort. Everyone wants to give General Marshall and Admiral King whatever in the way of manpower, money, and materials they require for prosecution of the war; but there ought to be relentless weeding out not only of unnecessary expenditures in the so-called non-war budget but also wasteful projects masquerading as "war expenditures" in the war budget.

In its eleventh progress report since its establishment in September 1941, the Joint Congressional Committee on Reduction of Nonessential Federal Expenditures, headed by Senator Byrd of Virginia, stated last December that while accomplishments towards economy have been considerable, "what remains to be done is still greater". The committee expresses the belief that great opportunity exists for further savings in both the regular government departments and in the war agencies, and concludes with the following pertinent observation:

> Even today the country as a whole does not feel the full impact of the debt load, for the financial horizon gives no promise of early relief, but rather a greater burden in the future. There was a time when the federal income tax was called a rich-man's tax; the masses believed that they would benefit and that the wealthy would pay the bill. Today all that has changed. From now on our federal expenditures will be traced directly to tax burdens in the lower-income brackets, it being estimated that 50,000,000 people will now file income-tax returns. The Secretary of the Treasury must have had a similar idea in mind when he stated: "For the first time in our history the income tax is becoming a people's tax."

It is of course true that the bulk of the revenue collected under the personal income tax is still coming from the upper and medium income brackets. Nevertheless, as the committee and the Secretary have pointed out, the income tax has become less and less limited to a levy on the few, and more and more broadened to reach the many. With the high rates prevailing in the upper brackets, this is inevitable, and future spending by government must to an increasing degree be paid for out of the pockets of the great mass of the people.

State and Municipal Finances

In a preliminary appraisal of state revenues for 1943, the Tax Institute of New York has commented that "contrary to many pessimistic forecasts of a year or two ago the war has not impaired state revenues. For most of the states tax collections are holding up well and show an increase of revenue for the third or fourth consecutive year. Generally speaking, therefore, the war has not necessitated the raising of additional revenues, but it has made desirable various adjustments in the revenue system."

A year ago when the legislatures of 42 states were in regular session, we made the observation that the financial positions of the majority of states were stronger than they had been for many years, and that the retention and earmarking of surplus balances for post-war needs, for purchase of United States Government bonds, for contingency reserves, or for acceleration of debt retirement, manifested a sound fiscal policy. With a few exceptions there was no great move to reduce taxes, since most states felt that an extended war might well lead to a sharp reversal of the experience up to that time.

Instead of meeting with any reversal, the upward trend of revenues continued through 1943. It would be interesting to see whether the same standards of fiscal policy are being maintained, and while specific comparisons are limited by the fact that only eight state legislatures are in regular session at this time, a number of reports dealing with budgets and financial estimates are available. It appears that New York State estimates a cumulative surplus on April 1 of $148,000,000, or over twice the $69,000,000 announced a year ago; that Pennsylvania's surplus should approximate $100,000,000 at the end of its May 1, 1945 biennium, compared with a $71,000,000 deficit five years ago; that Ohio has a surplus of over $68,000,000 in the general revenue fund, as against $42,000,000 at the end of 1942; and that in Mississippi revenues since Pearl Harbor have run 64 per cent higher than for the previous two years. Returns from Missouri, California, Washington, Nevada, Arkansas and Texas all report receipts either moderately or considerably higher. On the other hand, Connecticut, Rhode Island, and Kentucky within the past six months have experienced some decline, due mainly to the falling off in liquor taxes. Gasoline and motor license revenues, as well as other highway and bridge tolls, during the last quarter of 1943 were generally more stable and in some cases higher than in comparable months of 1942.

Judging from these reports and from the recommendations being made as to the use of surpluses, it appears that for the period ahead fiscal policy will be as conservative as a year ago. New York State, for example, has frozen its entire $148,000,000 surplus as a post-war reconstruction fund, and Mississippi intends to set aside at least $17,570,000 for retirement of

state debt. In the case of the Ohio surplus, $24,000,000 has been reserved for post-war construction of buildings and for welfare and educational purposes. Idaho's small general obligation debt will be retired in full, leaving $400,000 to $600,000 annually to be devoted to post-war building. In Virginia the Governor went so far as to recommend a referendum on a sales tax to finance expanded state activities after the war. Nearly everywhere, programs are being formulated to assist returning veterans, with Oregon, California and New Jersey leaning in the direction of granting assistance through loans for business, home construction or education.

Question of Municipal Share in State Revenues

In considering possible adjustments in state revenue systems made necessary by the war, the Tax Institute refers to the wave of legislation offering tax deferments or exemptions to servicemen, to higher imposts on luxuries, to modifications of special levies and the like. To this might be added the renewed efforts by municipalities for greater state aid, the most recent example being the appeal by the New York State Conference of Mayors and other officials to Governor Dewey for a larger participation in such taxes as highway, income, excise and others collected by the state.

The New York mayors proposed also that municipalities be allowed to impose additional levies, including a payroll or wage tax similar to that which Philadelphia has been collecting. The petitioners were mainly urban communities where growth and real estate trends have been affected by a migration of home owners to outlying areas or by the growing obsolescence of buildings. Their contention was that improvements in transportation after the war would accelerate these trends, and that only through such assistance would cities and villages be able to "meet economic changes without impairing their taxing power."

While the appeal resulted in the approval of a grant of $19,500,000 for one year only, this temporary relief was accompanied by the warning from Governor Dewey that "the idea that the state with its comparatively tiny budget ($190,000,000) should or could bail out the municipalities with their gigantic budgets ($1,250,000,000) simply melts away upon analysis." The trouble, he implied, had been due to "unsound fiscal policies" and "continuous refunding of debts," two matters which he hoped would be improved by sounder budgetary laws and closer fiscal supervision.

The mayors' appeal should not be taken as reflecting serious trouble at present in the fundamental position of urban communities, but rather as showing that municipalities, whose income is largely dependent upon real estate taxes, are becoming more conscious of the desirability of broadening the base of taxation for the future. An aggravating factor of nationwide application has been the increasingly large amount of property held by the United States Government and thereby made tax-exempt. Competent authorities estimate that government-owned real estate acquired in the past two and one-half years approximates the area of seven eastern states, bringing the federal domain up to a total of 383,600,533 acres, which is one-fifth the area of the continental United States.

Reduction of Debt

In reviewing the record of the past year, it is clear that with debts reduced, current tax collections at peak levels and relief responsibilities at a minimum, the financial positions of municipalities are generally better than for many years past.

A recent bulletin of the U. S. Department of Commerce contains estimates that for the year ended June 30, 1943 the combined debt of state and local governments was reduced by $1,000,000,000, compared with a reduction of $540,000,000 during the preceding fiscal year. The peak debt figure, according to these estimates, was reached on June 30, 1940, when the total was $20,225,000,000, compared with $18,645,000,000 on June 30, 1943. Deducting sinking fund assets on hand, net debt stood on the latter date at $16,399,000,000, a reduction of about 6 per cent for the year.

With this substantial reduction of state and municipal debt, and with the accumulation of surplus balances, it is to be hoped that the post-war period may witness the return of state and municipal governments to the practice of financing their own projects, rather than depending upon the Federal Government for aid.

The Growth of Money in Circulation

In December the extra holiday demands for currency, superimposed on the strong long-term upward movement that has prevailed in recent years, carried the total of money in circulation across the $20 billions mark for the first time. The record volume of money in use today is four times that of the previous business peak in 1929, and three times that of 1939 when the war started. This extraordinary expansion in currency has, along with moderate gold losses, been a drain upon bank reserves at a time when deposit expansion required more reserves, hence was a principal factor in the rapid increase of Federal Reserve credit needed to maintain reserve funds at adequate levels. With the ratio of the Reserve Banks' own reserves to Federal Reserve note and deposit liabilities now down around 62 per cent, an interesting question is how much longer the expansion of currency will continue.

If, as appears likely, business activity in the aggregate is now around its peak, and the rise in payrolls tapers off, there would be good reason to expect a check in the upward movement of currency demand—or at least some slowing down in the rate of increase. Likewise, the currency needed for payrolls and supplies of our armed forces may increase at a slower rate now that enrollment in the services is near its probable maximum. Other factors, however, seem to have come into the situation during the past year or so and may be influential in shaping the currency curve during the coming year.

Long-Term Trend of Circulation

Up to 1930, the trend in this country was for business transactions to be settled less and less with currency, and more and more with checks. Per capita circulation in 1914 was but $35, and in 1929 but $39. Even before World War I it was commonly asserted that over 90 per cent of business was settled with bank checks.

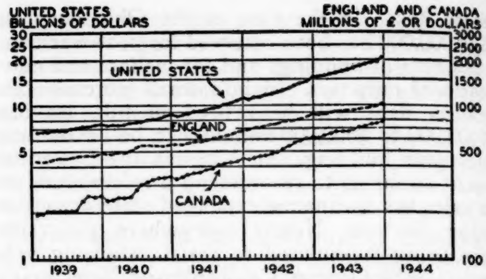
In the early 1930s the trend was reversed. The number of bank closings curtailed banking facilities, and stimulated the hoarding of currency. Following the banking difficulties, the Administration instituted its broad policy of relief spending. The large government disbursements directly to individuals contributed to the tendency of money to remain out of the banks. More "till money" was required by merchants to handle the cashing of relief checks. Elimination of interest on demand deposits and the spread of service charges caused large numbers of checking accounts to be closed out.

In the late 1930s an important new factor was the heavy inflow into this country of capital seeking refuge from the unsettled conditions abroad and placed, to substantial extent, in bank notes secreted in safe-deposit boxes or elsewhere. By 1939 foreign preparations for war were stimulating this country's industrial activity, and in 1940 still more expansion occurred as our own national defense program got under way. Circulation by that time had risen to $8 billions, or nearly $60 per capita.

Wartime Demands for Currency

After the outbreak of war the increase of currency circulation was greatly accelerated and the total, as already stated, is now over the $20 billions mark, or about $150 per capita. There was a tremendous outpouring of funds through government expenditures, which lifted sales and payrolls to new high levels. A great deal of this increased income is going to people who heretofore were in the low income groups and have no bank accounts.

That the wartime expansion of currency is by no means peculiar to this country is shown by the accompanying chart.



Currency Circulation in Three Countries

This shows a marked similarity in expansion since 1939 in three countries, although the rise in the United States over the five-year period has been at a somewhat higher rate than in Great Britain, but at a somewhat lower rate than in Canada. Currency increases have in fact appeared in varying degree in practically all important countries, including not only those now at war but most neutrals as well.

In the United States, the areas where the demands for new money have been greatest may be seen from the figures of the twelve regional Federal Reserve Banks on the issuance of Federal Reserve notes, which have made up the major portion of the total new money issued during recent years. The following table shows the net changes that have taken place since August 1939, just prior to the outbreak of war, in such circulation. These notes may circulate outside of their own districts, but when received by other Reserve Banks they are automatically returned to the issuing banks for redemption, which tends to maintain the regional significance of the figures.

Federal Reserve Note Circulation, by Districts
(In Millions of Dollars)

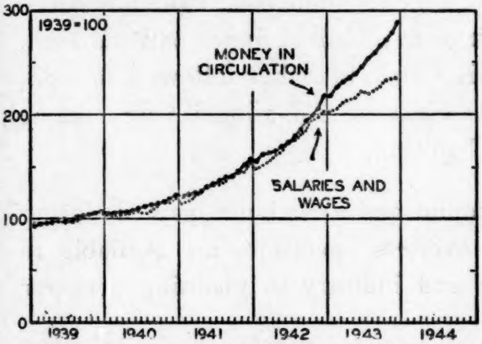
	Outstanding Aug. 30, 1939	Outstanding Jan. 19, 1944	Change Amount	Change Per-cent
Boston	$ 393	$ 1,149	+ 756	+192
New York	1,160	3,759	+2,599	+224
Philadelphia	323	1,151	+ 828	+256
Cleveland	430	1,506	+1,076	+250
Richmond	206	1,134	+ 928	+450
Atlanta	153	949	+ 796	+520
Chicago	1,017	3,180	+2,163	+213
St. Louis	180	725	+ 545	+303
Minneapolis	133	387	+ 254	+191
Kansas City	174	617	+ 443	+255
Dallas	78	410	+ 332	+426
San Francisco	362	1,939	+1,577	+436
Total	$4,609	$16,906	+12,297	+267

These figures present an amazing pattern of geographical shifts in income distribution resulting from war industry and expanded agricultural returns. That the largest actual increases in circulation have occurred in the New York and Chicago districts is not surprising in view of the huge concentration of population and of industry in those areas. More striking perhaps are the heavier percentage increases recorded in such districts as Richmond, At-

lanta, Dallas, St. Louis, and San Francisco, which have benefited both from heavy expansion of war industries and high farm income.

New Factors in Currency Demand

Until about a year ago there was a close correlation between the trends of currency circulation and wage and salary payments—which comprise about 70 per cent of national income —but recently there has been a divergence of trends, as shown in the accompanying chart, suggesting that new factors may be coming into the situation that need to be taken into account in projecting currency trends.



Indexes of Currency Circulation and Wage and Salary Payments. 1939 = 100.

In addition to heavy legitimate uses, there is evidence of growing demands for currency from "black market" operators who are reported to deal in many different articles at prices above the OPA ceilings, and who naturally try to avoid bank records of their dealings. At the same time, some of the merchants doing an extensive business in used automobiles, furniture, antiques, old jewelry, etc., are reputed to deal strictly on a cash basis in both buying and selling, with only a minimum of bookkeeping records, in order to evade taxation. In fact, the extremely high income tax rates now prevailing afford to large numbers of people a high premium on evading taxes on any income not reported to the Treasury at the source.

With the lowering of income tax exemptions, many people not having bank accounts have adopted the practice of storing up currency for the payment of their taxes. Moreover, many people have misunderstood the frequent proposals for "forced savings" (of a portion of income, through taxes and postwar refunds) to mean confiscation of savings accounts, and some owners of refugee money fear special taxes, or a "freezing" of bank deposits because of foreign connections.

A feature of the wartime currency expansion is the large increases that have occurred in bills of the larger denominations. While the grand total increased between August 1939 and November 1943 by 178 per cent, the $10s, $20s, $50s, and $100s increased by about 200 per cent or more, but the $1s, $2s, and $5s by 100 per cent or less. The $10s, and $20s alone make up more than half of the total circulation, and accounted for more than half of the total increase, as will be seen from the following summary:

Currency in Circulation, by Denomination
(In Millions of Dollars)

	Outstanding Aug. 1939	Outstanding Nov. 1943	Change Amount	Change Percent
Coin	$ 566	$ 1,006	+ 440	+ 78
$1s	521	886	+ 365	+ 70
$2s	34	68	+ 34	+100
$5s	966	1,950	+ 984	+102
$10s	1,681	5,127	+3,446	+205
$20s	1,487	5,561	+4,074	+274
$50s	433	1,416	+ 983	+227
$100s	857	2,761	+1,904	+222
$500s	180	388	+ 208	+116
$1,000s	405	729	+ 324	+ 80
$5,000s	17	10	— 7	— 41
$10,000s	30	19	— 11	— 37
Total	$7,171	$19,918	+12,747	+178

Since 1939 the circulation of $1,000 bills increased by 80 per cent, which was less than the overall average, yet a very substantial dollar amount. Although $1,000 banknotes are hardly a common medium of exchange, there are more than 700,000 of them in circulation today, an increase of more than 300,000 since the outbreak of war. The $100 bills are in greater demand today than ever before. Since the war started the number in use has risen from 8,000,000 to 27,000,000, an extraordinary total considering that currency has always been looked upon as the "small change" of business payments.

It remains to be seen whether currency expansion will continue this year at its prevailing high rate if business should level off and if the mobilization of our armed forces should be practically completed. If the demand for money should continue to soar, it will call for a re-examination of all factors influencing the currency trend. It may be that tax evasion and black market operations have become more important influences in money supply than had been realized. In that case the tax program, instead of concentrating still heavier burdens upon present taxpayers, might intensify efforts to reach large income which is apparently evading taxes. Some of this money might be reached through more rigid tax enforcement, and some might be reached through sales or excise taxes that would apply when such money was spent.

OVERSEAS BRANCHES

ARGENTINA
Buenos Aires
Flores *(Buenos Aires)*
Plaza Once *(Buenos Aires)*
Rosario

BRAZIL
Rio de Janeiro
Pernambuco
Santos
Sao Paulo

CANAL ZONE
Balboa
Cristobal

CHILE
Santiago
Valparaiso

COLOMBIA
Bogota
Barranquilla
Medellin

CUBA
Havana
Cuatro Caminos *(Havana)*
Galiano *(Havana)*
La Lonja *(Havana)*
Caibarien
Cardenas
Manzanillo
Matanzas
Santiago

ENGLAND
London
117, Old Broad St.
11, Waterloo Place

INDIA
Bombay

MEXICO
Mexico City

PERU
Lima

PUERTO RICO
San Juan
Arecibo
Bayamon
Caguas
Mayaguez
Ponce

REPUBLIC OF PANAMA
Panama

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